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SUBJECT: AUSTR STRATFORD AND DOC DAS KASOFF REVIEW  
U.S.-CHINA TRADE AND INTELLECTUAL PROPERTY AGENDA

Ref A) Guangzhou 00218

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¶1. (SBU) Summary: During a March 31-April 1 visit to Beijing that marked the first USTR/Commerce senior visit under the new Administration, Assistant U.S. Trade Representative (AUSTR) for China Affairs Timothy Stratford and Department of Commerce Deputy Assistant Secretary for Asia Ira Kasoff outlined latest developments and priorities in the U.S. trade agenda for a range of senior officials, all of whom expressed eagerness to engage the new administration in a positive way. AUSTR Stratford pressed the National Reform and Development Commission (NDRC) and the Ministry of Commerce (MOFCOM) on China's failure to adjust its steel output during the past year, even as other producing countries were cutting back sharply on production. Chinese officials stressed central government efforts to restructure and stimulate China's domestic economy to counteract the effects of the global economic downturn and maintain economic growth. The officials also repeatedly raised their opposition to U.S. actions on Chinese poultry imports. Ref A covered Stratford's April 1-3 meetings in Guangzhou and Shenzhen. End Summary.

NDRC DG Chen: Focus on Stimulus, Industry Plans

¶2. (SBU) NDRC DG Chen Bin told AUSTR Stratford and DAS Kasoff April 1 that China's RMB four trillion stimulus package is aimed at stimulating domestic demand, revitalizing key industries, and "safeguarding the livelihood of the people". Chen said 90 percent of the stimulus package funds were focused on China's domestic markets. Regarding foreign investment in China, he said "only a small percentage of foreign investment projects are subject to central government approval", as roughly 90 percent of investment projects are not subject to national approval. With respect to China's industry support/revitalization plans for ten key industries,

the NDRC's primary focus is on restructuring. The global financial crisis and reduced demand for exports has forced China's industries to reduce production, creating a difficult situation. However, even without the global financial crisis, China would still need to restructure its industries, Chen added.

#### Chinese Steel Exports Drop, But Not Domestic Demand

13. (SBU) Citing the steel industry revitalization plan as an example, Chen said the plans would "stabilize production." Since July 1, 2007, China has had a policy to discourage steel exports and steel exports have decreased as a result of measures such as increased taxes, he stated. Chen attributed the global destabilization of steel production to "other countries'" failure to stimulate domestic demand, noting that China would stimulate domestic demand in order to compensate for reduced external demand. The steel industry plan would also promote environmental protection by moving more than 30 polluting steel factories out of big cities.

#### AUSTR Stratford: Increased Bilateral Dialogue Needed...

14. (SBU) In the meeting with Chen and other officials, AUSTR Stratford highlighted the need for increased dialogue between the United States and China. He said the U.S. would be pleased to share its experiences on restructuring of industry.

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Noting Premier Wen Jiabao's criticism of countries with high consumption and low savings, Stratford said the United States, like China, needs to find a balance between consumption and savings. The current crisis highlights the fact that no country can afford to rely on an unsustainable strategy of maintaining high savings and high production while basing their economic growth on exports to the United States. Both China and the United States need to make structural adjustments, and dialogue will help ensure that our actions do not harm each other. While recognizing that China has the authority to make its own economic decisions, the United States will offer suggestions for cooperation and share ideas with China.

#### ...Accompanied by Greater Transparency

15. (SBU) Regarding China's industry revitalization plans, AUSTR Stratford advocated for attaining a higher degree of transparency to build trust and improve bilateral cooperation. He reiterated the need for China to make public the details of its ten industry support plans, which would help the United States resist domestic pressure for protectionist measures. In response, DG Chen stated that details of the steel and auto industry plans had already been announced and posted to NDRC's website and promised other plans would also be released publicly. Given the large number of ministries involved and the more than 120 measures included in the plans, NDRC would publicize them in a "gradual, step-by-step" manner, he said.

#### DAS Kasoff Raises GE/Harbin, Pharma Pricing, Baxter

16. (SBU) DAS Kasoff raised several commercial issues. First, on the GE/Harbin Power Equipment Corporation's proposal for the Shanghai Lingang Power Plant, Kasoff urged the NDRC to give the proposal every appropriate consideration. DG Chen responded that both GE and Harbin Power Equipment

Corporation were "very capable" firms whose joint project had "a good chance" of being approved. Second, Kasoff suggested that the topic of domestic pharmaceutical pricing should be viewed in the context of overall health care financing and decisions should be made in an open and transparent manner. Chen did not have any information on pharmaceutical pricing but promised to convey the matter to the appropriate NDRC department. Finally, Kasoff also urged China to give Baxter China adequate time to phase out the use of polyvinyl chloride (PVC) in intravenous infusion bags or face possible job losses. Chen promised to "seriously study" the request regarding Baxter China.

17. (SBU) Kasoff closed with an invitation to the NDRC to send a representative to participate in the April 29th Institute of Scrap Recycling Industries (ISRI) convention in Las Vegas; Chen indicated that a Deputy Director General from NDRC would likely attend.

MIIT Luncheon: MIIT DG Chen Yin Floats Expanded IIWG

18. (SBU) DAS Kasoff hosted on April 1 a luncheon for Ministry of Industry and Information Technology (MIIT) International Cooperation Department DG Chen Yin and colleagues. Kasoff began by asking Chen to explain MIIT's desire (expressed earlier to Emboff) to expand the Information Industries Working Group (IIWG) and explain MIIT's issues of interest. Chen said that MIIT wanted to use the Joint Commission on Commerce and Trade (JCCT) as a platform to expand cooperation beyond telecommunications to other sectors such as autos, raw materials, and consumer

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goods. The expanded WG could discuss how to save energy and reduce emissions, for example. Kasoff explained that the range of issues involved very different people on the U.S. side. Chen explained that the WG could be subdivided into subgroups or dialogues to discuss specific issues/sectors. Level of the subgroups would not be important - they could still be lead by Director Generals, Deputy Director Generals, or Division Directors. He pointed out the IIWG had been at the DG level for many years and the overarching WG and subgroups or dialogues could be at the same level. Kasoff said that this was an interesting concept that the US could consider as the US wanted to explore how to strengthen the WGs to make them more effective.

DAS Kasoff: Baxter, Remanufacturing, MIIT Reorganization and Telecom

19. (SBU) DAS Kasoff raised four other specific issues, including the Industrial Restructuring Catalogue and the implementation of new requirements that would impose a ban on PVC IV bags produced by Baxter in China. Kasoff asked whether MIIT or NDRC was responsible for issuing the catalogue, and requested that MIIT ensure that Baxter be permitted at least three years to comply so that Baxter's Shanghai employees would not lose their jobs. He also indicated that Baxter would like to meet with Vice Minister Ou to discuss the matter, and asked DG Chen to help facilitate. Chen acknowledged Kasoff's request and said that MIIT was now responsible for issuing the catalogue and leading the effort to solicit input from other entities. Kasoff inquired about China's policy on remanufacturing and pilot program on heavy equipment. Chen explained that NDRC is still in charge of remanufacturing, and that it had already completed a pilot program on auto parts. Chen said that China wanted the original

manufacturers to do remanufacturing to guarantee quality. Kasoff also asked how MIIT's information security office related to other Chinese ministries with responsibility for information security. Chen indicated that while this used to be the purview of the State Council Information Office, it had been folded into MIIT, which raised it to the Ministry level, and its functions expanded. Lastly, Kasoff asked whether China was considering further reductions in its telecom capitalization requirements. Chen did not directly respond, instead recounting the history of discussions in the JCCT on this issue, noting that everyone was now waiting for the NPC to approve the draft Telecom Law.

AUSTR Stratford: U.S. Awaiting Details on Industry Support Plans

¶10. (SBU) AUSTR Stratford inquired about China's recently released industry support plans, stressing U.S. companies' keen interest in obtaining specific details of the plans. Chen said that NDRC and MIIT had worked jointly on the plans, and that the detailed plans were currently being published. He explained that the financial crisis was having a big impact on Chinese companies, but that MIIT was beginning to get positive results from implementation of the plans. Declining production trends had been reversed and idled capacity had been reinvigorated, with auto output up in February. China had encouraged auto purchases domestically by reducing the tax on auto purchases by half, to five percent. Low emission cars were now being produced. Chen promised that details of all plans would be out soon and the U.S. would see that the plans were, in fact, not just a response to the current economic crisis but a long-term restructuring plan based on mergers and acquisitions,

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and scientific research.

AUSTR Stratford: U.S. Concerns On Government Procurement

¶11. (SBU) Stratford raised U.S. concerns about certain practices favoring domestic/local products, and explained the benefits of China's accession to the WTO Agreement on Government Procurement (GPA), including access to other members' government procurement markets. Chen countered that he had visited a Toyota factory in China and this Japanese factory's products were being procured by the Chinese government, so clearly China was open to "foreign" products. Beijing USTR Attache Chris Adams explained that for the purposes of government procurement in the U.S., where a product is produced, not factory ownership, determined whether a product was considered a U.S. product. Products produced in the U.S. by a wholly-owned foreign entity were considered US products for the purposes of government procurement.

DG Chen: China Has "Fewer Industrial Policies" than U.S.

¶12. (SBU) Stratford closed the luncheon by asking how many industrial policies China now has, to which Chen's colleagues quickly responded that the U.S. has more. According to recently completed research his department had done, China has only one tenth of the industrial policies that the U.S. and EU have. Kasoff pointed out that both sides must be using a different definition of "industrial policies," but more discussion on the topic was merited.

MOFCOM DDG Wen: U.S., Chinese Economies Intertwined

¶13. (SBU) AUSTR Stratford and DAS Kasoff discussed trade issues with MOFCOM DDG Wen Zhongliang on March 31. DDG Wen opened the meeting by noting that, generally, China's exports are in steep decline and that the U.S. and Chinese economies are intertwined, so both are suffering under the current global economic crisis. China is under great pressure from its industries and companies because of the lack of demand from international consumers for Chinese products. Wen encouraged the United States to implement another stimulus package to provide momentum for the U.S. economy that might result in increased demand for Chinese products.

DDG Wen: China's Steel Exports to U.S. Down 37.5 Percent Year on Year

¶14. (SBU) Presenting several statistics on the state of China's steel industry, DDG Wen said that exports have dropped dramatically, especially in the first two months of this year. In 2008, overall exports dropped 5.5% to 59.2 million tons and 2008 imports also dropped 8.7% to 15.4 million tons. In the first two months of 2009, total steel exports fell 52% while steel exports to the U.S. fell 37.5%. Wen linked the downturn in the steel industry to more than 3 million lost jobs for China. While the global financial crisis is a financial crisis in America, in China it is having a negative effect on China's "real economy", inferring that the U.S. had particular responsibility for the current crisis. One element of China's response is a steel industry revitalization plan that will be in place until 2011, which promises greater efficiency and rationalization of current capacity.

AUSTR Stratford: China's 2009 Steel Output Same as 2008

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¶15. (SBU) Responding on steel, Stratford noted the current economic situation was difficult for both Chinese and U.S. steel industries. He produced a chart showing that in 2008 China accounted for one-third of world total steel production (January and February, 2008), whereas in the same timeframe in 2009 (January and February, 2009), China's share of world steel production had increased to almost fifty percent -- meaning that, in a year in which worldwide total production decreased in line with a drop in world demand, China's steel production had remained practically constant. The practical result was that other producers had to even more drastically curtail their own production. Regarding Wen's suggestion for another U.S. stimulus, AUSTR Stratford reiterated points made earlier to the NDRC regarding Premier Wen Jiabao's criticism of "certain countries" [Read: the United States] with high consumption and low savings. Stratford concluded by noting that the current situation presented an opportunity to work together towards necessary long-term systemic adjustment in a cooperative spirit.

U.S. Concerns About Policy Measures to Favor Exporters

¶16. (SBU) AUSTR Stratford also addressed China's recent increase in value-added tax rebates for many steel products, along with China's use of administrative measures to increase exports and continue production at prior levels even as steel companies cut production. The message that other

steel producing countries are receiving is that China will strengthen itself at the expense of other economies, he said. China's policy of placing differential export duties on certain product categories like wire rod and aluminum gives China's downstream producers the benefit of lower cost inputs for higher value-added products -- a benefit that U.S. wire rod downstream producers do not have. Stratford said these policies greatly concern U.S. steel producers as well as the U.S. government.

DDG Wen: China Banking on Stronger Domestic Steel Demand

¶17. (SBU) DDG Wen countered that China's steel production level has not changed much but repeated that China's exports have drastically decreased, with the bulk of production going instead to domestic projects. He explained that China's continued steel production was intended for domestic consumption which would be boosted by China's economic stimulus package, which focuses heavily on infrastructure. Given the high cost to shut down and then restart steel mills, recent increases in value added tax rebates for certain steel products are justified, he asserted. Moreover, WTO rules allow China to provide VAT export rebates as long as such rebates are not excessive, and China showed restraint in the recent changes, as the highest level of any rebate is only 13 percent, not the full rebate of 17 percent.

¶18. (SBU) AUSTR Stratford responded that U.S. mills have the same cost difficulties in terms of mill shut downs, and the U.S. is aware of the WTO provision allowing VAT export rebates. However, the actions of the Chinese government as well as Chinese steel companies thus far do not seem to reflect economic reality. While other countries idle their mills and lay off workers while awaiting renewed demand, Chinese changes in VAT rebates makes it appear that China wishes foreign producers to bear a greater share of the burden associated with the decline in global demand. Stratford regretted that

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he did not have time to go into details, but he said the U.S. had similar concerns about China's trade policies and industrial policies for other metals including, particularly, aluminum.

China Upset Over Section 727 of Appropriations Bill...

¶19. (SBU) DDG Wen raised Section 727 in the 2009 U.S. Omnibus Appropriations bill, which effectively bans imports of poultry from China. He noted that the Chinese complained about this issue in 2008 and understood that the Bush administration was working to ensure that such a provision was not included in subsequent legislation. The Chinese government was disappointed to see the provision included in the 2009 Omnibus Appropriations Act and hoped the Obama Administration would seek to rectify the situation. AUSTR Stratford said he is familiar with the issue and has already told Obama Administration officials of China's concerns. Pending WTO litigation precluded more extensive statements on the issue at this time.

...and Interested in USITC Textile Monitoring

¶20. (SBU) As a final point, DDG Wen raised U.S. International Trade Commission (ITC) monitoring of textile imports from China. He explained that the Chinese and U.S. textile industries are complementary and benefit from good trade relations.

He noted that the Chinese side does not want a return of the special safeguard or quota arrangements. AUSTR Stratford ended the meeting by responding that while the ITC is certainly monitoring the inflow of textiles, to his knowledge it is not applying any restrictions to imports of textiles, merely monitoring the flow.

¶21. (U) This cable was cleared by U.S. Embassy Beijing USTR Senior Representative Christopher Adams and U.S. Embassy Beijing DOC/MAC Director Teresa Howes for USTR/Commerce. Also representing USTR/DOC on the delegation: Deputy Assistant U.S. Trade Representative for Intellectual Property Enforcement Kira Alvarez and DOC China Officers Ellen Szymanski and Tom Dycus.

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